

SUMMARY ANALYSIS OF AMENDED BILL

Franchise Tax Board

Author: Nation Analyst: John Pavalasky Bill Number: AB 198

Related Bills: See Prior Analysis Telephone: 845-4335 Amended Date: APTBA

Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Credit For Qualified Reduced-Emission Vehicles And Business Equipment/Depreciation Deduction/No Deduction Allowed For Large Luxury Sport Utility Vehicles (SUV)

☒ DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as amended August 18, 2003.

☒ AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.

AMENDMENTS DID NOT RESOLVE THE DEPARTMENT'S CONCERNS stated in the previous analysis of bill as introduced/amended _____.

FURTHER AMENDMENTS NECESSARY.

DEPARTMENT POSITION CHANGED TO _____.

☒ REMAINDER OF PREVIOUS ANALYSIS OF BILL AS AMENDED August 18, 2003, STILL APPLIES.

☒ OTHER - See comments below.

SUMMARY

This bill would deny the general California business incentives relating to vehicles when a business purchases a large luxury sport utility vehicle (SUV). The revenue from disallowing these incentives would be used to fund credits for the purchase and use of qualified reduced-emission vehicles and qualified reduced-emission business equipment in this state.

SUMMARY OF AMENDMENTS

The proposed amendments would change the effective dates of the credit and deduction denial to apply to taxable years beginning on or after January 1, 2005, and before January 1, 2009. In addition, the bill is modified to:

- Allow a credit for qualified vehicles under the Clean Vehicle Program and qualified projects under the Carl Moyer Particulate Matter Tax Credit Program established in these amendments.
- Sunset the credit only after the three-year recapture period has expired.
- Strikeout the exceptions to the denial of business deductions for farming businesses, timber businesses, and construction businesses.
- Allow "hybrid vehicles" and those costing less than \$35,000 to be exempt from the impact of the deduction denials.

Board Position:

_____ S _____ NA _____ NP
_____ SA _____ O _____ NAR
_____ N _____ OUA ☒ PENDING

Legislative Director

Date

Brian Putler

6/16/04

A new analysis of the credit and the deduction denial is provided to reflect the proposed amendments. In addition, a new revenue estimate is provided. Except for the EFFECTIVE/ OPERATIVE DATE, the remainder of the analysis of the bill as amended August 18, 2003, still applies and is not repeated.

EFFECTIVE/OPERATIVE DATE

As proposed to be amended this bill, as a tax levy, would be effective immediately. However, this bill provides that the credit would apply to taxable years beginning on or after January 1, 2005, and before January 1, 2009, and a sunset date of January 1, 2012, is provided. The bill provides that the business incentive disallowance would apply to property placed in service on or after January 1, 2005, and before January 1, 2009, and a sunset date of January 1, 2010, is provided.

POSITION

Pending.

ANALYSIS

The proposed amendments to the credit are discussed separately from the proposed amendments to the deduction denial.

1. Credit For Qualified Reduced-Emission Vehicles Under the Clean Vehicle Program And Qualified Projects Under The Carl Moyer Particulate Matter Tax Credit Program.

FEDERAL/STATE LAW

Current federal law

A tax credit of 10% of the cost of a qualified electric vehicle is allowed in the year that it is placed in service by the taxpayer. The vehicle must be placed in service after June 30, 1993, and before 2007. The maximum credit is \$4,000 per qualified electric vehicle; however, for vehicles placed in service in 2004 through 2006, the credit is reduced 25%, 50%, and 75%, respectively.

A qualified electric vehicle is defined as one powered primarily by an electric motor drawing current from rechargeable batteries, fuel cells, or other portable sources of electric current. A portion of the credit is recaptured during the first three years after being placed in service if the vehicle ceases to be a qualified electric vehicle during that period.

Current state law

California has not conformed to this federal credit.

THIS BILL

This bill would, starting in 2005, allow taxpayers to claim a tax credit in the taxable year that a qualified reduced-emission vehicle that has been issued a tax credit certificate is purchased and placed in service in California or the taxpayer has been issued a tax credit certificate for a qualified project under the Carl Moyer Particulate Matter Tax Credit Program. The credit would equal:

- \$2,000 for a full-function Zero Emission Vehicle (ZEV) or a Partial Zero Emission Vehicle (PZEV) with at least a 20-mile ZEV range.
- \$1,000 for an Advanced Technology Partial Zero Emission Vehicle (ATPZEV).
- The amount contained in the tax credit certificate issued to a taxpayer for a qualified project under the Carl Moyer Particulate Matter Tax Credit Program.

Any unused credit would be carried forward to reduce tax in the next and succeeding five years. A prorated portion of the credit would be recaptured if the qualified vehicle or the assets comprising the qualified project is sold, disposed of, or not used at least 80% of the time in this state during the year placed in service and each of the succeeding two taxable years.

A qualified reduced-emission vehicle is defined as a new ZEV, PZEV, or ATPZEV that has been granted a tax credit certificate. A qualified project is defined as one that voluntarily and most cost-effectively reduces particulate matter pollution from any on- or off-road source that the taxpayer has been granted a tax credit certificate.

This bill requires the California Air Resources Board (CARB) under the Clean Vehicle Program to allocate the tax credit certificates to retail dealers on a first-come, first-served basis. To receive an allocation, the retail dealer must show that the number of tax credit certificates being requested reflects the number of qualified vehicles (without certificates) held as inventory by the dealer. The retail dealer is required to list the vehicle identification number on the tax credit certificate provided to the purchaser and retain a copy in its records.

Under the Carl Moyer Particulate Matter Tax Credit Program, the CARB may issue tax credit certificates to taxpayers for qualified projects that voluntarily and most cost-effectively reduce particulate matter pollution from any on- or off-road source and delegate authority to issue tax credit certificates to local air districts that agree to match the credit dollar for dollar with additional local air district funds. The CARB would administer and provide oversight of the Carl Moyer Particulate Matter Tax Credit Program and may impose additional restrictions on the authority delegated to local air districts in the interest of implementing the program most effectively to safeguard public health.

The maximum amount of credits that the CARB may allocate under the Clean Vehicle Program each fiscal year is equal to 50% of the Franchise Tax Board (FTB) estimate of revenue raised in the fiscal year arising from the disallowance of deductions for large SUVs. The maximum amount of credits that the CARB may allocate under the Carl Moyer Particulate Matter Tax Credit Program each fiscal year is equal to the remaining 50%. If there are any credits under the Clean Vehicle Program that have not been issued for the fiscal year, they are reallocated to the Carl Moyer Particulate Matter Tax Credit Program for issuance in the next fiscal year. The FTB is required to make that revenue estimate and provide its determination to the CARB on October 1, 2004, and each October 1 thereafter.

This bill requires that the taxpayer purchasing a qualified vehicle under the Clean Vehicle Program receive the tax credit certificate from the retail dealer. Under the Carl Moyer Particulate Matter Tax Credit Program, the taxpayer receives the tax credit certificate either from the CARB or the local air district. The taxpayer then claims the credit in the taxable year that a qualified vehicle or qualified project is implemented or placed in service in California. The taxpayer must retain the tax credit certificate and provide a copy upon request of the FTB.

This bill provides that the credit would apply to taxable years beginning on or after January 1, 2005, and before January 1, 2009, and a sunset date of January 1, 2012, is provided.

2. Eliminate Deductions For Large Luxury SUV

FEDERAL/STATE LAW

Current Federal Law

Under federal law a corporate or noncorporate taxpayer (other than estates, trusts, or certain noncorporate lessors) may elect to treat the cost of qualifying property (called Section 179 property) as a current expense rather than being required to depreciate the property over a number of years. The Jobs And Growth Tax Relief Reconciliation Act (JGTRRA) of 2003 increased the maximum deduction for 2003, 2004, and 2005 from \$25,000 to \$100,000.

This maximum deduction is reduced, on a dollar for dollar basis, once assets costing more than \$400,000 (increased from \$200,000 by JGTRRA) have been placed in service by the taxpayer during the taxable year. This reduction is the mechanism used to target the benefit to small businesses.

Federal law also contains rules (called the luxury car limits) that limit the amount of depreciation or Section 179 expensing that can be deducted each year for certain passenger vehicles. These luxury car limits apply to leases of passenger vehicles by requiring an amount to be added to income in each year of the lease (using tables issued by the Internal Revenue Service) based on the fair market value of the vehicle for that year. For purposes of the luxury car limits, a passenger vehicle is any four-wheeled vehicle manufactured primarily for use on public streets, roads, and highways that has an *unloaded* gross vehicle weight (i.e., curb weight fully equipped for service but without passengers or cargo) of 6,000 pounds or less. However, a passenger vehicle includes a truck or van (including a SUV or minivan) if it has a gross vehicle weight (i.e., maximum total weight of a *loaded* vehicle as specified by the manufacturer) of 6,000 pounds or less. Consequently, some large SUVs are not subject to the luxury car limits.

Current State Law

California is conformed, in general, to the federal Section 179 deduction and the luxury car limits for noncorporate taxpayers and S corporations, with the following differences:

- For non-corporate taxpayers, the maximum deduction for 2003 and later years is \$25,000.
- This maximum deduction is reduced, on a dollar for dollar basis, once assets costing more than \$200,000 have been placed in service by the taxpayer during the taxable year.

For corporations, the maximum expensing deduction is \$2,000. Also, the depreciable lives of corporate assets vary by type of asset but, in general, are longer than the depreciation period under federal law.

In addition, California allows a business operating in the following economic development areas, in lieu of the Section 179 deduction, to deduct currently as an expense (rather than depreciate) a larger portion of a depreciable asset (defined by reference to Section 1245(a)(3) of the Internal Revenue Code):

- Enterprise Zones (EZ's),
- Local Agency Military Base Recovery Areas (LAMBRA's), and
- Targeted Tax Area (TTA).

THIS BILL

With respect to large SUVs, as defined, placed in service in 2005 and later, this bill would deny depreciation deductions as well as small business expense deductions (including those pertaining to enterprise zones (EZ), local area military base recovery areas (LAMBRA), and targeted tax areas (TTA)) to the owners of these vehicles.

Thus, if a taxpayer purchases a large SUV, or the taxpayer leases the large SUV under a finance lease (i.e., the taxpayer and not the leasing company is treated as the owner of the vehicle), that taxpayer would be denied depreciation deductions as well as small business expense deductions with respect to that vehicle. In addition, if the taxpayer leases a large SUV under an operating lease (i.e., the leasing company is treated as the owner of the vehicle), the leasing company would be denied depreciation deductions as well as small business expense deductions with respect to any large SUVs that are leased to others. In addition, a taxpayer with an operating lease would be denied the business expense for the lease payments.

This bill, as proposed to be amended, no longer exempts agricultural, timber, and construction businesses from the deduction denials. However, the proposed amendments would allow “hybrid vehicles” and those costing less than \$35,000 to be exempt from the impact of the deduction denials.

This bill would define a large SUV as a four-wheeled vehicle manufactured primarily for use on public streets, roads, and highways if the vehicle meets all of the following requirements:

- (1) Is rated between 6,000 and 14,000 pounds gross vehicle weight,
- (2) Is designed to seat nine or fewer individuals, and
- (3) Is not equipped with an open cargo area with an interior length of 72 or more inches or does not have a covered box with an interior length of 72 or more inches that is separate from the passenger compartment.

A “hybrid vehicle” would be defined as a vehicle capable of accelerating to at least 15 miles per hour using only electric, hydraulic, or other zero emission drive.

ECONOMIC IMPACT**Revenue Estimate**

Based on the discussion below, the following table reflects the estimated impact of this bill:

Revenue Impact of AB198 As Proposed To Be Amended For Taxable Years Beginning On Or After 1/1/2005 Fiscal Years (In Millions)				
	2004-05	2005-06	2006-07	2007-08
SUV Deductions	+\$5	+\$20	+\$35	+\$20
Qualified Vehicle/Projects Applied Credits	\$0	-\$20	-\$35	-\$25
Revenue Impact	+\$5	\$0	\$0	-\$5

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this measure.

Revenue Discussion

The impact of this bill would depend upon all of the following items.

- The number and costs of large SUVs.
- The amount of reduced depreciation and expense deductions that would have been allowable under current law.
- The amount of tax decreases resulting from the resale of large SUVs at higher cost basis.
- The number of qualified reduced-emission vehicles/projects placed in service in California.
- The amount of the tax credit certificate issued per qualified reduced-emission vehicles/project.
- The number of taxpayers claiming the reduced-emission vehicles/project credit.
- The average applied credit against tax liabilities.

For purposes of this analysis, information obtained from a report released by US Public Interest Research Group in 1999 was used. In addition, the following assumptions were made:

- (1) Assumed that approximately 50% of large SUVs sold or leased currently are allowed some sort of deduction. Of these vehicles it is estimated that approximately 20% qualify for both operating lease deductions and depreciation deductions.
- (2) The average annual deduction per vehicle is \$5,000.
- (3) The average write-off period for these vehicles is three years.
- (4) The business use of leased SUVs would decline by 15% annually as a result of this bill.
- (5) The average marginal tax rate of 6% was used.

SUV Deductions

To arrive at the annual revenue gain, it was determined from the US Public Interest Research Group's report that approximately 760,000 qualifying vehicles would be sold or leased in the United States in 2004. Of this total it is estimated that 11% would be located in California (84,000).

Assuming 60% of the vehicles would no longer receive an average deduction of \$5,000, disallowed deductions would amount to approximately \$250 million for vehicles purchased or leased in 2005. Assuming an average marginal tax rate of 6% the first year, revenue gain is estimated to be approximately \$15 million ($6\% \times \$250 \text{ million} = \15 million). The fiscal-year estimates above reflect changes in estimated tax and final tax payments. That is, it was assumed that approximately one third of the \$15 million first-year revenue gain would be reflected in increased estimate payments in the 2004-05 fiscal year resulting in the \$5 million estimate for that fiscal year. Credits, however, exhibit a different fiscal-year pattern as discussed below.

The above revenue impact for the SUV deduction represents a timing effect, reduced depreciation deductions, and expenses offset in future years by a decrease in the amount of gain realized from the sale of the vehicle due to its unreduced basis under this bill.

Qualified Vehicle/Project Applied Credits

According to the Air Resources Board, it is estimated that the number of qualifying vehicles/projects will exceed the estimated increase in state taxes. Therefore, all of the estimated increase in state taxes for any given fiscal year would be allocated to the credit.

The fiscal year cash flow patterns reflect applied credits in the respective years and are based on an analysis of how taxpayers adjust their tax payments to reflect a change in liability resulting from current law. That is, prior fiscal year estimated tax payments are not typically adjusted to take into account the availability of the credit but instead, because of the carryover, the application of the credit is reflected in the succeeding fiscal year. Thus, applied credits reflect not only the credits allocated in 2007-08, but also the carryover of unapplied credits from prior fiscal years.

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